Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

ESTATE OF JOSEPHINE T. THOMPSON, Deceased, CARL T. HOLST-KNUDSEN and THE BANK OF NEW YORK, Executors,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In 1998, responding to the concern that individual and small business taxpayers are often at a disadvantage in litigation with the Internal Revenue Service ("IRS"), Congress enacted the Internal Revenue Service Restructuring and Reform Act, also known as the "Taxpayer Bill of Rights." Section 7491 of the Act provides that the burden of proof on any fact-driven issue will shift to the IRS Commissioner if a taxpayer produces all relevant documentation, cooperates with inquiries by the IRS, and presents "credible evidence," which has been uniformly defined as evidence sufficient to establish the basis for a decision in the taxpayer's favor, subject only to the introduction of contrary evidence by the Commissioner.

In this case, although the taxpayer met the standard for shifting the burden, and the Commissioner, whose only evidentiary submission was held to be worthless, indisputably failed to prove his case, the Tax Court failed to find in the taxpayer's favor. The Second Circuit Court of Appeals, interpreting the statute in a manner that conflicts with decisions of other Circuit Courts, affirmed the Tax Court's ruling.

The question presented is:

Whether a taxpayer who has met all criteria for shifting the burden of proof under IRC § 7491 is entitled to judgment in its favor when the Commissioner fails to prove his case and his only evidentiary submission is rejected by the Tax Court.

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PETITION FOR A WRIT OF CERTIORARI

Estate of Josephine T. Thompson, Deceased, Carl T. Holst-Knudsen and The Bank of New York, Executors, respectfully petitions that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit entered on August 23, 2007.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit, 499 F.3d 129, is dated August 23, 2007. (App. A-1) The opinion of Judge Swift of the Tax Court, 2004 WL 1658404, is dated July 26, 2004. (App. A-17)

JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was entered on August 23, 2007. A Petition for Rehearing and Petition for Rehearing En Banc was timely filed, and was denied on November 14, 2007. (App. A-81) Pursuant to Supreme Court Rule 13, this petition has been filed within 90 days of the denial of rehearing.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). The jurisdiction of the Court of Appeals was invoked pursuant to 26 U.S.C. §§ 7482(a) and 7483. The jurisdiction of the Tax Court was invoked under 26 U.S.C. §§ 6213 and 7442 and Tax Court Rule 13(a).

STATUTORY PROVISION INVOLVED

This petition involves the interpretation and application of Section 7491 of the Internal Revenue Code, 26 U.S.C. § 7491 (herein, "Section 7491"), enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, which provides, in subsection (a), that, as a general rule, "[i]f, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue." IRC § 7491(a)(1). (App. A-83)

The provision limits application of this general rule to cases in which the taxpayer, in addition to meeting the "credible evidence" requirement, has also: (i) "complied with the requirements under this title to substantiate any item"; and (ii) "maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews." IRC § 7491(a)(2). (App. A-83)

STATEMENT OF THE CASE

This case involves the valuation of the late Josephine T. Thompson's minority interest in Thomas Publishing Company ("TPC"), a closely-held, family-owned publisher of directories founded in the late 19th century by Mrs. Thompson's father. Mrs. Thompson died on May 2, 1998, and included in her estate (the "Estate") were 487,440 shares — approximately 20.5% — of the stock of TPC.

In 2002 the Estate petitioned the Tax Court, challenging a determination by the Commissioner of Internal Revenue (the "Commissioner") that the Estate had undervalued the TPC stock on its federal estate tax return. The Commissioner's deficiency notice valued the TPC stock at $72.36 per share (as of May 2, 1998) and assessed a tax deficiency of $17,910,408.26 and imposed additions to tax of $7,164,163.30.

At trial the Estate offered the reports and testimony of valuation experts that the TPC stock was properly valued at $3.59 per share, using the capitalization of income method. This valuation took into consideration such factors as TPC's declining profitability, the industry outlook in the 1990s for traditional print-directory publishers, and TPC's failed attempts and ongoing efforts — at huge expense — to try to adjust to the digital information revolution, including the meteoric rise of the Internet. In further support of this valuation analysis, the Estate submitted, *inter alia*: the testimony of TPC's President and two experts on investing in the directory-publishing industry; financial records reflecting TPC's struggle to survive (with nearly $14 million in losses by 2001); extensive internal TPC documentation — prior to May 1998 — regarding management's fears that the company was at grave risk; and scholarly articles on the paradigm shift in publishing that by 1998 had already destroyed several venerable reference-book publishers.

In response to the Estate's request, the Tax Court ruled that the Estate, through its experts' report and other evidentiary submissions, had introduced credible evidence in support of its valuation as

required by Section 7491. This ruling was later confirmed by the Tax Court in a footnote in its opinion: "At trial, we determined that for purposes of sec. 7491(a)(1), the evidence produced by the estate as to the valuation of the TPC stock was to be treated as credible evidence." (App. A-46) As discussed further below, although Section 7491 does not define what constitutes credible evidence, the courts have consistently adopted the definition set forth in the conference reports preceding enactment of the statute: "Credible evidence is the quality of evidence which, *after critical analysis*, the court would find *sufficient upon which to base a decision on the issue* if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness)." H. Conf. Report. 105-5999, at 240-241 (1998) (emphasis added).

It was undisputed that the Estate also met the additional requirements of IRC § 7491(a)(2). Accordingly, the Tax Court recognized that the Commissioner, not the Estate, "has the burden of proof with regard to the valuation of the estate's 20-percent stock interest in TPC." (App. A-46)

The Tax Court's proper application of Section 7491 ended there, however. Indeed, in its July 2004 Memorandum Findings and Fact and Opinion, the Tax Court treated the statute as a nullity, making no reference at all to the burden of proof — except in the footnote quoted above, which merely confirmed its ruling at trial. Certainly the Tax Court made no finding that the Commissioner, as required by the statute, had met its burden of proof on the valuation issue. On the contrary, the Tax Court emphatically rejected the Commissioner's only proffered evidence — the appraisal opinion of a valuation expert — as

worthless in every respect, finding that the expert had not only used the wrong methodologies but had made no attempt at all to understand the nature or operation of TPC's business. (App. A-71-73) The Tax Court concluded that the Commissioner's expert had adopted a "sterile approach" and "did not appear to make an effort to base his valuation of TPC on a real company." (App. A-71). The Tax Court also noted that there were "significant errors" in this analysis and that the Commissioner's changing calculations involved "significant questionable adjustments" that were "suspect, not sufficiently explained, and not persuasive." (App. A-46, A-54, A-73).

Moreover, the Commissioner submitted no evidence at all on the key factual issue underlying the valuation of TPC's stock: the impact of the digital information and Internet revolutions on TPC's prospects as of May 1998. The Estate's experts concluded that any reasonable buyer in May 1998 would have understood that TPC was facing a serious downturn due to these cataclysmic changes — and that the purchase price of any TPC stock would have reflected this. This conclusion was supported not only by internal TPC documents, industry studies, and the testimony of industry experts and TPC's management, but also by an economics expert, Kenneth Lehn, former chief economist for the Securities and Exchange Commission, who testified as to the significance of TPC's plummeting operating margins and negative growth rate between 1994 and 1997. Indeed, TPC's financial records for the 1998-2002 period (showing a 90% decline in income, a growth rate of *negative*

44%, and huge losses) confirmed that the company's grim early forecasts were, if anything, not grim enough.[1] (App. A-36)

The Commissioner's valuation, rejected in toto by the Tax Court, took none of this into account. The Commissioner submitted no fact witnesses, no industry experts, and no industry studies to support his position — or contradict the Estate's position — on the impact of the Internet.

Nonetheless, despite the Commissioner's patent failure to meet his burden of proof, the Tax Court did not enter judgment for the Estate, as required by the statute. Instead, the Tax Court made its own valuation, calculating the value of the TPC stock at $27.75 per share. The Tax Court adopted the methodology and certain findings of the Estate's experts but altered two critical calculations, increasing the valuation of the TPC stock by over $10 million, based on the Court's startling conclusion that "the Internet, as of May 2, 1998, constituted a factor for TPC almost as positive as it was negative." (App. A-73-74)

The Tax Court referred to no evidence submitted by the Commissioner in making this finding with regard to the impact of the digital information revolution on TPC's prospects. The Commissioner's sole witness — his expert, whose valuation was deemed worthless by the Tax Court — claimed no expertise with respect to either the relevant industry or the Internet. In fact, to the limited extent that the

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[1] As the Tax Court acknowledged, post-death facts such as these are properly considered in the valuation analysis. (App. A-44-45) (citing cases).

Tax Court referred to the record in reaching its conclusion that TPC faced no serious threat from the Internet, it referred to the same body of evidence — the testimony of TPC's President, the report and testimony of the Estate's experts, TPC's financials and internal documents — that the Tax Court previously found to constitute a credible evidentiary showing sufficient to support a finding that the Estate had proven its valuation.[2]

In accordance with the Tax Court's opinion, a Decision of the Tax Court was entered on November 3, 2005, finding a deficiency in the estate tax due from the Estate in the amount of $3,397,255.91. The Decision also reflected the Tax Court's finding that, under the "reasonable cause" exception (IRC § 6664) to the penalties to be imposed under IRC § 6662, the Estate owed no penalty. (App. A-15)

Subsequently, the Estate filed a timely appeal to the United States Court of Appeals for the Second Circuit challenging the Tax Court's decision on the ground, *inter alia*, that the Tax Court had failed to apply Section 7491 by not holding the Commissioner to his burden of proof. Indeed, given the meaning of "credible evidence" for purposes of Section 7491, the Tax Court's decision was, on its face, in conflict with the statute. Having found the Estate's case sufficient to support a finding in its favor if no contrary evidence were submitted by the Commissioner, the

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[2] In an apparent attempt to justify its failure to apply IRC § 7491(a), the Tax Court stated in its opinion that the Estate's valuation experts, previously deemed "credible," were actually, in the Tax Court's view, only "marginally credible." (App. A-66)

Tax Court then threw out the only evidence submitted by the Commissioner — yet failed to make a finding in favor of the Estate.

On appeal, the Second Circuit affirmed the Tax Court's rulings as to valuation (except for one relatively minor error in calculation). The Second Circuit acknowledged that, under Section 7491, the Estate's evidentiary showing had shifted the burden of proof on the issue of valuation to the Commissioner.[3] (App. A-6) The Second Circuit did not deny that the Commissioner had failed to prove his case and, indeed, was excoriated by the Tax Court for the patent inadequacy and suspect nature of his expert's valuation. Nor did the appellate court deny that the Commissioner had failed to submit any evidence, other than the discredited opinion of his expert, either to support his own case or to contradict that of the Estate.

Notwithstanding this record, the Second Circuit held that the Tax Court was free to reject the Estate's "credible" valuation and substitute a valuation of its own devising. (App. A-7) The appellate court did not expressly find that the Commissioner had met his burden nor did it explain why the Commissioner did not need to prove his case in accordance with traditional burden-of-proof principles. Instead, the Second Circuit decision suggested that the Commissioner's burden of proof

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[3] The Second Circuit's decision erroneously stated that "the parties stipulated" to the Estate having met the threshold of having made a "credible" evidentiary showing. (App. A-7) In fact, the Commissioner refused to stipulate to the credible evidence threshold, forcing the Tax Court to rule on this issue in favor of the Estate. (App. A-46)

under Section 7491 can be satisfied merely by offering arguments against the taxpayer's case and by citing "evidence in the record that impeaches, undermines, or indicates error" in the taxpayer's calculation. The Second Circuit did not identify what record evidence supported the Commissioner's arguments, stating that "the Tax Court adopted some of the Commissioner's arguments in opposition to the Estate's valuation. . . ."[4] Moreover, the Second Circuit indicated that its finding might have been the same even if the Tax Court had rejected all arguments advanced by the Commissioner in opposition to the Estate's valuation, "or if the Commissioner had made no such arguments." (App. A-7 n.2)

In affirming the Tax Court's decision, the Second Circuit further stated that, in a valuation case, the reallocation of the burden of proof under Section 7491 does not require the Tax Court to adopt the taxpayer's valuation, "however erroneous," when the Tax Court rejects all aspects of the Commissioner's valuation. (App. A-7) However, the Second Circuit failed to recognize that the burden of proof would never be shifted to the Commissioner unless the taxpayer's case had already been found, after "critical analysis," to be sufficient to satisfy the credibility and substantiation standards of Section 7491 and to support a finding in the taxpayer's favor.

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[4] Similarly, the appellate decision set forth a conclusion that the Tax Court's valuation was not "clearly erroneous" because there is "evidence to support" its findings but did not identify this evidence. (App. A-8)

The Second Circuit's opinion was issued, and judgment was entered, on August 23, 2007. A Petition for Rehearing and Petition for Rehearing En Banc, timely filed, was denied on November 14, 2007. (App. A-81)[5]

REASONS FOR GRANTING THE PETITION

The application of the statute in this case by both the Second Circuit and the Tax Court renders Section 7491 a virtual nullity, frustrating the legislative intent to level, at least to some degree, the playing-field between taxpayers and the Internal Revenue Service. This case demonstrates that there is disagreement among the Circuit Courts of Appeal, and confusion within the Tax Court, as to the significance of the "burden of proof" in tax cases and the proper application of Section 7491, particularly in valuation cases.

This is an extremely important moment in tax jurisprudence. In enacting Section 7491 Congress changed the landscape of Tax Court adjudication, placing the burden of proof on the Commissioner where the taxpayer has, *inter alia*, made a "credible" evidentiary showing on a fact-driven issue. The legislative mandate is clear: if the taxpayer meets its threshold burdens, the burden shifts to the Commissioner to prove that a contrary finding is

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[5] In its decision, the Second Circuit also found that the Tax Court's findings with respect to the reasonable cause exception under § 6664 were insufficient and remanded for further findings. (App. A-13) That aspect of the decision was not challenged in the Petition for Rehearing and is not at issue on this Petition.

required. All courts, including the Second Circuit in this case, have agreed that Section 7491 applies to the Tax Court's valuation findings.

As detailed below, the courts of several Circuits have held that when Section 7491, or some other rule of law, places the burden of proof in a valuation case on the Commissioner, and the Commissioner fails to prove his valuation by a preponderance of the evidence, the Tax Court, in accordance with essential burden-of-proof principles, must find for the taxpayer. This result is consistent with the Congressional mandate and ensures judicial economy, limiting the number of cases in which the Tax Court is required or empowered to search the record and make its own valuation.

The law of the Second Circuit, however, as set forth in this case, is that the Tax Court may decline to find for the taxpayer, and take on the role of appraiser, no matter how abjectly the Commissioner fails to prove his own valuation — so long as the Tax Court agrees with any argument made against some aspect of the taxpayer's valuation by the Commissioner. Indeed, the Second Circuit has gone even further, suggesting that Section 7491 might not require the Tax Court to find for the taxpayer even if the Commissioner both fails to prove his own case and offers *no arguments* and cites *no evidence at all* in opposition to the taxpayer's valuation. This

interpretation of the burden of proof, which renders Section 7491 meaningless in virtually all valuation cases, appears to be unprecedented.[6]

The Second Circuit's decision not only conflicts with the approach taken in other Circuits but, contrary to the mandate for judicial economy implicit in the statute, it provides a blueprint for an increased burden upon the Tax Court, with myriad valuations created by judges rather than appraisers, and upon the Court of Appeals as well, given the extensive evidentiary issues raised on appeals from judge-made valuations. Moreover, the Second Circuit's decision sends a message, contrary to both the letter and spirit of the statute (a vital component of the "Taxpayer's Bill of Rights"), that, in any income or estate tax case, the Commissioner can submit a baseless valuation many times larger than the taxpayer's and count on the Tax Court to step in and arbitrarily "split the difference" — even when, as here, the taxpayer's valuation has met the requirements that shift the burden of proof to the Commissioner.

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[6] *See* John A. Bogdanski, *From the Editor*, 11 Valuation Strategies 3, 2007 WL 4328637 (November/December 2007), in which the commentator analyzes the Second Circuit's "novel" approach in this case and observes that the appellate court's "explanation of the burden of proof seems to reduce its significance." Contrasting the Second Circuit's analysis with commonly understood burden-of-proof principles, the commentator asks: "Can a taxpayer bear the burden of going forward while the IRS bears the burden of ultimate persuasion under Section 7491? That would seem a revolutionary idea." *Id.*

A. Background of the Statute and the "Credible" Test

Section 7491 was enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998 (Pub. L. 105-206, 112 Stat. 685, enacted 1998-07-22), also known as the "Taxpayer Bill of Rights." (App. A-83) The Act resulted from the work of the National Commission on the Restructuring of the Internal Revenue Service, popularly known as the Kerry-Portman Commission, and responded to the concern that "individual and small business taxpayers frequently are at a disadvantage when forced to litigate with the Internal Revenue Service." S. Rep. No. 105-174, at 44-46 (1998). Following oversight hearings of the Senate Finance Committee in September, which focused in part on the need for expanded protections for taxpayers, *see, generally, Practices and Procedures of the Internal Revenue Service, Hearings before the Senate Comm. on Finance*, 105th Cong. (1997), initial proposals were made by both House and Senate for a burden-shifting provision.

The provision included in the House version of the Act provided that the burden of proof would shift to the Commissioner when, along with all other requirements, the taxpayer "asserts a reasonable dispute with respect" to any factual issue. H.R. 2676, 105th Cong. § 301 (1997). However, the bill as enacted imposes a far more rigorous threshold for the taxpayer to meet before the benefits of burden-shifting can be obtained. The "credible evidence" test in the final version of Section 7491 has been consistently interpreted to require the taxpayer not merely to demonstrate a "reasonable dispute" but

effectively to establish the basis for a decision in the taxpayer's favor — subject only to the introduction of contrary evidence from the Commissioner.

Courts that have addressed and determined the meaning of "credible" in the context of Section 7491 (as the Second Circuit did not) have referenced and relied upon the definition suggested by the legislative history. The House Conference Report that preceded enactment of the Restructuring Act states:

> Credible evidence is the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). A taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible factual assertions, frivolous claims, or tax protestor-type arguments. The introduction of evidence will not meet this standard if the court is not convinced that it is worthy of belief.

H. Conf. Report, 105-599, at 240-241 (1998), 1998-3 C.B. 747, 994-995 (emphasis added). *See, e.g., Blodgett v. C.I.R.*, 394 F.3d 1030, 1035 (8th Cir. 2005) (adopting language from House Report to define "credible evidence"); *Thompson v. United States*, 523 F.Supp.2d 1291, 1296-97 (N.D. Ala. 2007) (same). The taxpayer must also demonstrate that it has maintained all records required for purposes of section 7491(a)(2)(B) and has cooperated with reasonable requests from the IRS for witnesses, information, documents, meetings and interviews for purposes of section 7491(a)(2)(B).

Thus, for a taxpayer, meeting this initial burden under Section 7491 is not, as might be inferred from the Second Circuit's opinion, by any means a mechanical, minimalistic, or routine threshold showing. The Tax Court is required to subject the taxpayer's evidence to "critical analysis" and determine that this evidence, standing alone, would support a decision for the taxpayer. Given the nature of the test, it is hardly surprising that, since the enactment of Section 7491, "the cases in which the taxpayer has successfully shifted the burden of proof, absent a concession by the Commissioner, have been few." M. McMahon, Jr. & L. Zelenak, FEDERAL INCOME TAXATION OF INDIVIDUALS, 3d Ed., Warren Gorham & Lamont (2007), ¶51.02. Whether the taxpayer has succeeded in shifting the burden is a serious obstacle for the taxpayer and a frequent matter of dispute.

In *Kohler v. C.I.R.*, T.C. Memo 2006-152, 2006 WL 2059210 (U.S. Tax Ct. July 25, 2006), for example, the Tax Court's weighing of arguments on the hotly contested issue of whether the taxpayer had met the threshold occupies a significant portion of the decision. *Id.* at **6-7. Other decisions, too, highlight the "critical analysis" and skepticism employed by the Tax Courts in restricting the number of cases in which the burden is shifted. The Tax Court is free to reject evidence that is "uncorroborated, although uncontradicted, evidence by interested witnesses." *Estate of Erickson v. C.I.R.*, T.C. Memo 2007-107, 2007 WL 1364407 (U.S. Tax Ct. April 30, 2007), at *6 (finding that taxpayer failed to meet initial IRC § 7491 burden). It will also reject, *inter alia*, "broad, generalized testimony" that lacks sufficient probative value or evidence that "cuts both ways." *Davenport v. C.I.R.*, T.C. Memo 2006-

215, 2006 WL 2845690 (U.S. Tax Ct. Oct. 5, 2006), at *4 (finding against taxpayer on IRC § 7491 threshold).

Thus, once a taxpayer has met the substantial hurdle of submitting evidence sufficient to satisfy the statute, as well as other requirements, holding the Commissioner to his burden of proof in a meaningful way is appropriate and reasonable as well as consistent with the language of the statute.[7] Certainly the framework suggested by the Second Circuit, where the Commissioner may utterly fail to prove his case and do little (or even nothing) even to refute the taxpayer's case, yet still be found to have "met his burden," negates the clear Congressional intent to right the historic imbalance in tax jurisprudence.

B. Decisions in Conflict with the Second Circuit Decision

The Second Circuit's view of the burden of proof in tax cases, and with respect to Section 7491 in particular, conflicts with that of the Circuit Courts of Appeals and the Tax Court in other jurisdictions.

1. *Decisions of the U.S. Court of Appeals*

The U.S. Court of Appeals for the Fifth Circuit has long recognized the principle that, once the burden of proof shifts to the Commissioner under a statute, he must prove the correct amount of taxes owed. *See,*

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[7] Clearly, as noted above, the Second Circuit's rationale for not holding the Commissioner to his proof — *i.e.*, that it could result in the adoption of substantially "erroneous" taxpayer valuations — is inconsistent with the evidentiary requirements imposed on taxpayers seeking to shift the burden of proof.

e.g., *Carson v. United States*, 560 F.2d 693 (5th Cir. 1977). That principle was applied in a dispute over valuation in *Caracci v. C.I.R.*, 456 F.3d 444 (5th Cir. 2006), where the burden of proof on valuing a closely held business was found to have shifted to the Commissioner.[8] As in the case at bar, the Tax Court rejected the testimony of the Commissioner's valuation expert, but also found fault with the taxpayer's appraisal — and so proceeded to assemble its own appraisal: "The Tax Court adopted only one part of one of [the expert's] market-value approaches, making adjustments and filling in gaps to reach its own conclusion as to value." *Id.* at 454.

Reversing, the Fifth Circuit found that the Tax Court should have simply found for the taxpayer:

> [T]he Tax Court rejected most of the only support the Commissioner provided for the net excess benefit finding, the testimony of the Commissioner's valuation expert. At that point, the Commissioner failed to meet his burden of proof. At that point, the Tax Court should have found in the taxpayers' favor.

Id. at 457-58. This analysis by the Fifth Circuit is in direct conflict with that of the Second Circuit, which held in this case that the Commissioner can be found to have met his burden of proof in a valuation case even if his valuation expert's report and testimony have been rejected in their entirety.

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[8] In this case the burden shifted not pursuant to Section 7491 but, as a matter of case-law, due to "naked assessment." 456 F.3d at 457.

The U.S. Court of Appeals for the Eighth Circuit, in *Griffin v. C.I.R.*, 315 F.3d 1017 (8th Cir. 2003), reversed the ruling of the Tax Court that the taxpayers had failed to establish that they were entitled, under Section 7491, to shift the burden of proof to the Commissioner on whether the taxpayer was entitled to deduct certain real estate payments. Moreover, the *Griffin* court rejected the argument that the burden of proof could be assumed to be of no consequence to the outcome: "[I]f that were the case, § 7491(a) would have no meaning." *Id.* at 1022. Accordingly, the Eighth Circuit directed the Tax Court to hold the Commissioner to his burden of proof and "*prove* the non-applicability" of the exception claimed by the taxpayer by submitting contrary evidence. *Id.* at 1021 (emphasis added). Unlike the Second Circuit, the Eighth Circuit did not suggest that the Commissioner's burden could be met by merely arguing that the taxpayers' case — already deemed credible — was purportedly "undermined" by certain facts already in evidence.

Following the directives of the Court of Appeals, the Tax Court found for the taxpayers after concluding that the Commissioner "has offered insufficient contrary evidence to overcome petitioners' evidence. Accordingly, respondent has failed to sustain his burden of proof." *Griffin v. C.I.R.*, T.C. Memo 2004-64, 2004 WL 440431 (U.S. Tax Ct. Mar. 11, 2004), at *4 (footnote omitted).

The U.S. Court of Appeals for the Ninth Circuit, similarly, has treated the burden of proof as a meaningful and rigorous basis for entering a finding for the taxpayer — and *not* as an invitation to the Tax Court to undertake its own valuation. *See, e.g.*, *Morrissey v. C.I.R.*, 243 F.3d 1145, 1147-48 (9th Cir.

2001), *rev'g and rem'g*, 77 T.C.M. (CCH) 1779 (1999) (ordering that judgment be entered for taxpayer where expert report of Commissioner, who had burden of proof, was rejected by Tax Court, which attempted an independent valuation); *Estate of Simplot v. C.I.R*, 249 F.3d 1191, 1196 (9th Cir. 2001), *rev'g and rem'g*, 112 T.C. 130 (1999) (same).

Finally, the U.S. Court of Appeals for the Seventh Circuit has also held, in a nearly mirror-image context, that when the party with the burden of proof in a valuation case fails to make its case, the Tax Court should ordinarily find that the other party has prevailed outright — rather than try to fashion a valuation of its own. In *JPMorgan Chase & Co. v. C.I.R.*, 458 F.3d 564 (7th Cir. 2006), the Tax Court had rejected the valuation of the taxpayer, who had the burden of proof, but, instead of accepting the Commissioner's valuation, devised a methodology of its own. The Seventh Circuit reversed, holding that, absent a finding that the Commissioner's approach was "arbitrary or unlawful," the Tax Court should have found in the Commissioner's favor. This analysis is, again, in conflict with that of the Second Circuit, which attaches no dispositive consequences to the failure of a party with the burden of proof to prove its own case.[9]

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[9] *See* J. Bogdanski, *supra*, which notes the conflict between *Caracci* and *JPMorgan Chase* on the one hand, and *Estate of Thompson* on the other: the "Fifth and Seventh Circuits have recently issued opinions indicating that when the party with the burden of proof fails to persuade the court of the correctness of its valuation position, the other party to the litigation should prevail outright. That view is not shared by all the federal appeals courts." 2007 WL 4328637.

2. *Decisions of the Tax Court*

Given that relatively few taxpayers have thus far succeeded in meeting the requirements needed to shift the burden of proof under Section 7491, there are a limited number of reported cases involving the interpretation and application of the statute in a valuation setting. One such case, *Kohler v. C.I.R.*, 2006 WL 2059210, *supra*, decided two years after the Tax Court opinion was issued in this case, demonstrates — in striking contrast to the Second Circuit's approach — how Section 7491 can and should be applied in a manner consistent with traditional burden-of-proof principles, legislative intent, and judicial economy.

The *Kohler* Tax Court recognized that the statute is plainly intended to impose a genuine burden-of-proof obligation upon the Commissioner in appropriate circumstances. In *Kohler*, as in this case, the taxpayer cleared the hurdle of complying with all requirements, including the submission of a valuation of a portion of a privately held company supported by credible evidence, to shift the burden to the Commissioner. *Id.* at **6-7. In *Kohler*, as in this case, the Tax Court rejected in its entirety the expert testimony of the Commissioner's appraiser. Based on that finding alone, the Tax Court then, *without any further analysis of the taxpayer's evidence*, found for the taxpayer and adopted the valuation submitted by the taxpayer's expert:

> We therefore give no weight to the respondent expert's conclusions. Respondent [the Commissioner] has therefore not met his burden

> of proof. Accordingly, we find the value of the estate's stock to be the amount the estate reported on its return. . . .

Id. at *13.

Only *after* having made this determination based on the burden of proof, the Tax Court went on to analyze in detail the expert reports submitted by the taxpayer and the Commissioner's arguments in opposition to the persuasiveness of the taxpayer's valuation. The Tax Court stated that these supplemental findings "lend *further* support to our conclusions" (*id.* at *13) (emphasis added), but it made clear that it did not need to have conducted any such additional analysis to reach its ultimate decision. At no point did the Tax Court in *Kohler* suggest that it would have been free to create its own valuation if the Commissioner — having failed to prove his own valuation or submit evidence contradicting the taxpayer's valuation — had merely argued that some fact in the record "undermined" the taxpayer's valuation.

Similarly, in *Forste v. C.I.R.*, T.C. Memo 2003-103, 2003 WL 1889626 (U.S. Tax Ct. April 16, 2003), the Tax Court meaningfully held the Commissioner to his proof once the burden had shifted pursuant to Section 7491. In *Forste*, the issue was whether certain payments received by the taxpayer were made in settlement of tort or tort type personal injury claims and therefore excludable from taxable income. After "extensive arguments" over whether the burden of proof could be shifted, and "before considering any contrary evidence submitted" by the Commissioner, the Tax Court found that the taxpayer had presented "credible evidence; i.e.,

sufficient evidence upon which to base a decision" that the payments at issue qualified for the exclusion. Accordingly, the Tax Court held that the burden of proof on this issue shifted to the Commissioner, who was now required to prove that the payment was *not* intended to settle personal injury claims.

The Tax Court then ruled that the testimony of the sole witness called by the Commissioner clearly failed to satisfy the Commissioner's burden of proving his case, even though the testimony might raise an inference sufficient "to detract from the weight" of the taxpayer's evidence. *Id.* Unlike the Second Circuit, which found that the Commissioner could meet his burden of proof merely by making arguments that detracted from the weight of the Estate's evidence, the Tax Court in *Forste* properly held that, once the burden of proof shifted, the Commissioner had to do much more than that. Given the Commissioner's failure to meet his burden of proof, the Tax Court found for the taxpayer.

C. Summary

Congress intended, with the enactment of 26 U.S.C. § 7491, to provide taxpayers with a substantive measure of relief from the historical disadvantages they faced in litigation with the Internal Revenue Service. The Second Circuit's misapplication of the statute constitutes a barrier to the realization of this legislative goal, as does the conflict and confusion reflected in the case-law (at the appellate level as well as in the Tax Court) surrounding both the interpretation of Section 7491 and, more generally, the application of burden-of-proof principles in tax litigation. Indeed, taxpayers will be discouraged from

even seeking the benefits of burden-shifting under Section 7491 as long as there is such deep uncertainty as to whether the courts will give the statute meaningful effect or render its benefits illusory.

Absent clarification and consistency, an important component of what was intended to be a "Taxpayer's Bill of Rights" is likely to remain unrealized, and Congress's effort to ensure due process for taxpayers will be frustrated. The need for resolution and guidance from this Court is particularly acute and urgent with respect to the burden of proof in estate tax cases and other tax cases that may turn on valuation issues. Unlike the courts of other Circuits, the Second Circuit has held that Section 7491 places no real limitations at all on the Tax Court's ability to substitute itself as the valuation expert whenever the Commissioner — unable to justify his own valuation — merely manages to raise an issue with respect to some aspect of the taxpayer's valuation (which the Tax Court has already subjected to "critical analysis" and deemed credible). This interpretation effectively nullifies the statutory directive to place the "burden of proof" on the Commissioner in valuation cases when the taxpayer meets the required evidentiary threshold. It also undermines the statute's significant potential for maintaining judicial economy by limiting the number of cases in which the Tax Court — which has no expertise in valuation — takes on the role of appraiser, and in which the appellate courts are called on to undertake a full evidentiary review.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be granted.

Respectfully submitted,

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